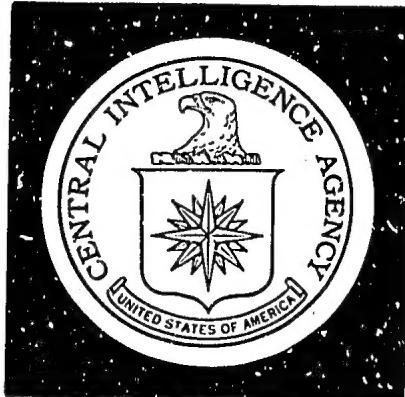


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DIRECTORATE OF
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Intelligence Memorandum

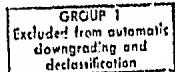
Soviet International Banking And Insurance

Secret

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1971

INTELLIGENCE MEMORANDUM

SOVIET INTERNATIONAL BANKING AND INSURANCE

Introduction

1. The rapid growth of East-West trade since the late 1950s and the concomitant rise in the requirements for financing this trade have been instrumental in the expansion of Soviet banking and insurance activities in the West. This memorandum examines the growth of the Soviet banks and insurance companies based in the West, their role in East-West trade, and their activities in other fields.

Discussion

Development of Soviet-Owned Banks in the West

2. Since the return to convertibility of currencies in Western Europe in 1959, Soviet-owned banks in the West have played an increasingly important role in the development of East-West trade, 1/ which increased from \$5.7 billion in 1958 to \$19.9 billion in 1970. Moscow Narodny Bank (MNB) in London and Banque Commerciale pour l'Europe du Nord (BCEN) 2/ in Paris – both relatively small in the pre-World War II era – have developed into large and diversified banking institutions. MNB opened a branch in Beirut in 1963, and another bank, Wozchod Handelsbank, A.G., was added in Zurich in 1966. 3/ At the end of 1970, the total assets

1. *Trade of the USSR, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania with the non-Communist world.*
2. *BCEN is commonly known by its cable address, EUROBANK.*
3. *The Russo-Iranian Bank in Teheran had already been established in 1923. It is not concerned with East-West trade per se. For a description of its history and functions, see Appendix A.*

Note: This memorandum was prepared by the Office of Economic Research and was coordinated within the Directorate of Intelligence.

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of the Soviet-owned banks was worth an estimated \$2 billion, nine times the 1958 value (see the table).

Assets of Soviet-Owned Banks in the West

<u>Year</u>	<u>MNB</u>	<u>BCEN</u>	<u>Wozchod</u>	<u>Million US \$ a/</u>	<u>Total</u>
1958	24	198	--		222
1959	151	380	--		531
1960	156	360	--		516
1961	219	426	--		645
1962	291	503	--		794
1963	520	550	--		1,070
1964	573	570	--		1,143
1965	653	632	--		1,285
1966	702	662	9 b/		1,373
1967	719	774	42		1,535
1968	775	843	61		1,679
1969	797	954	72		1,823
1970	873	N.A.	N.A.		2,000 b/

a. End-of-year assets. Converted from national currencies to US dollars at the appropriate exchange rates.

b. Estimated.

3. The Soviet-owned banks in the West were never intended to organize all or even a major part of the finance required for East-West trade - a matter which was largely left to Western banks. What they have done is to enhance the ability of the USSR to gather commercial intelligence, enter the foreign exchange and Eurocurrency markets, tap outside sources of funds, and ensure secrecy in some of the USSR's convertible currency dealings. Moreover, in recent years MNB and BCEN have been profitable operations, each earning a return on capital of 10% or more. Net profits of the Soviet-owned banks combined reached almost \$5 million in 1969.

4. The State Bank of the Soviet Union (Gosbank) and the Foreign Trade Bank of the Soviet Union (Vneshtorgbank) are the major shareholders of the Soviet-owned banks in the West and dictate their policies. Soviet citizens generally occupy the key posts in the Soviet-owned banks in the West, thereby ensuring adherence to the guidelines set by Moscow. Otherwise, the banks are staffed by local nationals who are hired for their

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banking expertise rather than ideology, although many of them are Party members. The bank managements adhere to the laws and customs of the countries in which they are incorporated and are largely autonomous in operational matters, especially in fields where their activities are prescribed by commercial considerations or accepted Western practice.

5. These banks provide banking services and financing of Western trade for the USSR and other Communist countries, especially those in Eastern Europe. To an increasing extent they have become involved in financing trade of non-Communist countries as well. Aside from foreign trade activities, they act as agents for gold sales in the West by the USSR and, occasionally, other Communist countries. The Soviet-owned banks also offer banking services to local customers, including the maintenance of current and time deposit accounts and the provision of short-term loans to private companies. Some of the activities of the Soviet-owned banks may be ascribed to a desire for their own institutional growth and profits rather than the promotion of East-West trade. Nevertheless, by expanding and diversifying their operations, these banks have enhanced their ability to provide financing and banking services for East-West trade and have helped to build the financial reputation of the Communist countries. By developing local customer relations, these banks have increased their deposits of Western currencies and have expanded the possibilities for the profitable use of their funds.

Moscow Narodny Bank, Ltd.

6. MNB was originally established in London in 1916 as an agency of the Moskovskiy Narodny Bank of Moscow, but became a separate legal entity in 1919. By 1929, MNB had assets of about \$40 million and branch offices in Paris, Berlin, and New York. With the depression, World War II, and finally the cold war, however, business fell off, branches were closed, and assets plunged. As late as 1952, MNB's assets were less than \$17 million, and its business was to remain slack for a few more years. Since 1958, however, its assets have expanded rapidly and its activities have taken on new dimensions.

7. MNB's assets at the end of 1970 were \$873 million, some 36 times the 1958 level. Almost three-fourths of its assets consist of advances and loans, and about one-sixth are in the form of balances held with banks and correspondents. 4/ The increase in MNB's resources over the years has come about largely through the increase in balances held with it by banks and correspondents, both Western and Communist. 5/ These balances,

4. Based on 1969 data, the latest year for which detailed data are available. For further details, see Appendix B.

5. MNB has about 150 correspondents in 50 countries.

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totaling \$714 million in 1969, comprised 90% of MNB's total resources, and about half are Communist held. MNB's resources also have been supplemented by the use of rediscount facilities in London, where MNB acceptances command the most favorable rates. Also contributing to MNB's growth has been the bank's policy since 1965 of not paying dividends, but transferring profits to its reserve account in order to build up its capital account. The cumulative value of such transfers - including its net profits of \$2.0 million in 1969 - exceeded \$10 million during 1965-70. In 1969, MNB increased its authorized capital by \$7.2 million to a total of \$19.2 million and, at the same time, increased its paid-up capital by \$2.4 million to a total of \$12.0 million. It increased its paid-up capital by another \$2.4 million in April 1971. These increases in capitalization are indicative of MNB's plans for continued rapid growth.

8. In addition to promoting and financing East-West trade, MNB provides some financing for Western exports to less developed countries. MNB also is active in foreign exchange and Eurocurrency markets both as borrower and lender. Since 1967, MNB has been a principal in the sale of Eurodollar Certificates of Deposit (CDs) and, since 1968, sterling CDs. In order to better manage its rapidly accumulating liquid resources, MNB established an investment department in 1966 which immediately became active in the gilt-edged market. By 1967, this department began operating, although to a lesser extent, in the new Eurodollar bond market, and it also began underwriting certain issues of stock on the London market. In this connection, MNB was one of the organizers of the recently successful offering by Hungary of a \$25 million Eurobond issue. In addition, MNB has further expanded its activities by the acquisition of two wholly-owned subsidiaries, Mosnar Investment Holding Company Ltd. and Mosnar Securities Ltd., whose combined assets and net profits in 1969 - apparently their first year of operation - were \$11 million and \$66,000, respectively. 6/

9. In October 1963, MNB opened a branch in Beirut, Lebanon, evidently because of the need to facilitate banking operations in an area where Communist trade was growing rapidly. Although the emphasis in the Beirut branch is the financing of East-West trade, it is also involved in foreign exchange operations. The London office claims that the Beirut branch is "foremost among the banks operating in Lebanon." Its assets (included in the total for MNB) may be \$100 million or more. There is no recent information on its profits, but they probably have grown since 1964, when they were stated to be about \$250,000.

6. *Included in MNB's balance sheet.*

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SECRETBanque Commerciale pour l'Europe du Nord

10. BCEN was founded in Paris in 1921 by a group of wealthy Russian emigres, who sold out to Soviet interests in 1925. Unlike MNB, BCEN experienced rapid growth in the immediate post-World War II period. In 1948, BCEN had assets of less than \$7 million, or only 10% of MNB's total assets at the time, but by 1958 BCEN's assets had reached roughly \$200 million - eight times those of MNB. This more rapid growth apparently was related to the confidence that Moscow had in Charles Hilsum, ^{7/} the BCEN manager at that time, prompting it to make funds available to (and channel business through) BCEN rather than MNB.

11. BCEN's assets at the end of 1969 were \$954 million, about 20% larger than MNB's and about five times those of 1958. Unlike MNB, the largest proportion - 87% - of BCEN's assets was in the form of cash, mainly deposits with banks and correspondents. ^{8/} Little more than 11% was allocated to advances and loans, that is, for the direct financing of trade. On the opposite side of the ledger, more than 91% of BCEN's resources came from deposits maintained almost entirely by banks and correspondents - deposits by banks and correspondents accounted for 89% of BCEN's total liabilities. BCEN's net profit of \$2.6 million in 1969 compares favorably with MNB's net profit of \$2.0 million. Its return on capital was 15%, compared with 16% for MNB. Similar to the policy of MNB, BCEN did not pay any dividends throughout most of the 1960s; instead, it transferred these profits to its reserves and steadily increased its capital, thereby providing for its further expansion.

12. The high proportion of cash on the assets side and the correspondingly small proportion used for commercial loans and advances indicate that BCEN does relatively little direct trade financing. Instead, it has induced a number of its Western correspondent banks to provide such trade credit. A considerable proportion of BCEN's deposits with its Western correspondents has served to secure lines of credit at these banks, primarily for Communist imports from the country in which the Western bank is located. Serving basically as a financial intermediary - as opposed to the direct financing of East-West trade -- BCEN is probably even more actively involved in Eurocurrency markets than is MNB.

Wozchod Handelsbank, A.G.

13. In October 1966, Wozchod Handelsbank, the newest of the Soviet-owned banks in the West, was established in Zurich. One of the major

^{8.} See Appendix B. BCEN has roughly 200 correspondents.

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more immediate motivations for Wozchod's establishment may have been the Soviet desire to tap a new and major source of Eurocurrency funds; another motive may have been the greater secrecy in monetary operations, including sales of gold, in Switzerland. The opening of a bank in Zurich was in any case a logical step in what appears to be a Soviet policy of increasing its banking operations around the world.

14. Wozchod Handelsbank has grown rapidly since its establishment in 1966. By 1968, its initial capital of about \$2 million had increased to roughly \$5 million, its present level. By the end of 1969, the bank's assets totaled \$72 million, roughly a 70% increase over 1967, its first full year of operation. Like MNB and BCEN, Wozchod relies heavily on deposits from other banks, which in 1969 accounted for nearly 90% of its total resources. Wozchod operates much in the same manner as BCEN, as more than 83% of its assets are in the form of cash and deposits with other banks, with only 13% involved in the direct financing of trade. 9/ The bank's net profits of \$257,000 in 1969, while almost five times those of 1967, still represented a return on capital of less than 6%.

15. Wozchod's small rate of return may be ascribed to the bank's newness, but it also suggests that the bank is currently overcapitalized in relation to its volume of business. 10/ At the same time, however, this could be indicative of Moscow's plans for the continued rapid growth -- and perhaps a greater role -- for its bank in Zurich, because an increase in a bank's capitalization generally precedes its expansion. There is substantial evidence that Wozchod's management lacks the expertise of its counterparts in London and Paris, and any expansion would require that its management be upgraded.

Role of the Banks in East-West Trade

16. The primary stated function of the Soviet-owned banks in the West is to facilitate Soviet trade with Western countries. The charters of BCEN and Wozchod Handelsbank specifically state that their purpose is to develop Soviet trade with France and Switzerland, respectively. MNB refers to itself more generally by its "second name," the Bank for East-West Trade. In practice all three banks provide their services to other Communist countries, including Yugoslavia, as well as to some of the less developed countries. The services are the same as those generally provided by Western banks specializing in international payments and include such items as making and collecting payments, direct financing, rediscounting, and

9. See Appendix B.

10. Wozchod's capitalization, more than 6% of total liabilities, compares unfavorably with MNB and BCEN, where the figure is less than 2%.

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processing trade documents. The Soviet-owned banks also provide the Communist countries with general commercial intelligence, particularly that pertaining to East-West trade. Through their credit departments and contacts with their Western correspondent banks, they can obtain credit information on Western importers and exporters that normally might not be available to Communist foreign trade firms and banks.

17. The trade financing offered by the Soviet-owned banks is similar to that offered by any large Western bank handling international payments. Although loans are primarily for periods of six months or less, some longer term financing is offered, especially for trade in capital goods. Because of their limited resources, however, the Soviet-owned banks generally restrict themselves to short-term financing. Consequently, the USSR and the East European countries have had to turn increasingly to Western sources to obtain the medium- and long-term loans required for their expanding imports of machinery and equipment from the West. Over the past decade they have borrowed several billion dollars from the West -- chiefly in the form of government-guaranteed supplier credits and other tied loans. The recent Hungarian \$25 million Eurobond issue, the first by a Communist country since World War II, likely will be followed by other Communist countries in an attempt to secure untied Western credits.

Involvement in Western Money Markets

18. MNB, BCEN, and Wozchod, being located in the leading European financial centers, are active participants in both foreign exchange and Eurocurrency markets. BCEN became active in European foreign exchange markets before MNB, apparently because of its earlier post-World War II development into a sizable international bank and its extensive relations with Western correspondents. MNB began to play an active role in the foreign exchange market only in 1961.

19. In the early 1950s, MNB and BCEN were among the first European banks to become involved in Eurodollar transactions. At first they were primarily lenders because of the unwillingness of their Communist correspondent banks (Gosbank, Vneshtorgbank, and the central banks and special foreign trade banks of the Communist countries) to hold more than working balances in US banks. This reluctance apparently stemmed from their belief that if East-West relations deteriorated, their Western currency balances in European banks would be safer (that is, less likely to be blocked by governmental authorities) than balances held in the United States. The Communist countries, however, were unwilling to exchange their dollar balances for the then less convertible West European currencies. As a result, Soviet and East European banks began to hold some of their dollar balances in MNB and BCEN, which in turn loaned them at profitable rates of interest

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in what became known as the Eurodollar market. The liberalization of exchange controls in Europe in 1958 increased the flexibility of the Eurodollar operations and allowed the development of active markets in European currencies as well as US dollars.

20. The position of MNB and BCEN in Eurocurrency markets gives the USSR and the East European countries additional flexibility in financial relations with the West. By building up their credit standing, MNB and BCEN have been able, when necessary, to become net borrowers in Eurocurrency markets. This ability to borrow in these markets serves both to augment the trade credit otherwise obtainable in the West and to cushion the disruptive effects of large emergency withdrawals by Communist or Western correspondents. In addition, the excellent reputations that MNB and BCEN have established in Western currency markets enable them to attract Eurocurrency deposits at prime rates - a factor of great importance for profitable operations. By building these reputations, MNB and BCEN have also been instrumental in establishing the credit-worthiness of the Communist countries and institutions associated with them. Wozchod Handelsbank, the newest Soviet entry in the Western banking world, probably shares in the confidence earned by MNB and BCEN.

Gold Sales

21. In addition to normal banking duties, the Soviet-owned banks in the West also act as agents for the USSR and, occasionally, for other Communist countries for sales of gold in the West. BCEN, for example, regularly sells North Korean gold. In the past, London was the major gold market in the world because of the special role of the Bank of England both in the Gold Pool and as agent for sales of South African gold. Accordingly, most Soviet gold was sold in London and smaller quantities in Switzerland and Paris. Because the central banks of the Group of Ten maintained the price of gold at \$35 per ounce, 11/ the USSR had to accept this price to be able to sell in large lots. Smaller markets, such as those in Beirut or Hong Kong, with their higher prices, would not have been able to absorb Soviet sales. Under the present two-tier system, Zurich has replaced London as the major gold market in the world and the USSR can obtain higher prices - currently more than \$40 per ounce - on the free gold market, but large lot sales might depress the price of gold. 12/

11. Plus a small markup on forward sales.

12. Small lots of Soviet gold were sold in the period December 1970 - March 1971, a total of about \$20 million. Most sales were made in Switzerland, and Wozchod is believed to have been the agent.

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Initiatives for New Banking Facilities

22. Soviet banking officials seemingly are interested in expanding their Western banking facilities. Prospects appear good for the establishment of additional facilities in West Germany, Singapore, and Pakistan. Aside from the advantages of increasing Soviet representation around the world, this expansion reflects the trend in international banking to expand overseas branches rather than to rely on correspondents to service customers overseas (see the map).

23. Negotiations for a bank in Frankfurt, West Germany, represent a second attempt. In 1967, a branch of MNB in that city appeared imminent. Applications were filed, directors were named, and official West German permission was all but guaranteed. An impasse apparently developed, however, and the branch office was never opened, thus ending negotiations which had been in the works for several years. In February 1971 the USSR and West Germany reportedly were again in agreement on the establishment of a Soviet banking facility in Frankfurt; however, the time for the opening is not known. A Soviet bank in Frankfurt would provide the USSR with another money market to tap, as well as a location in a major world gold market. Moreover, a bank in Frankfurt would be a very profitable operation since a large part of West German trade with the USSR likely would be channeled through the Soviet bank.

24. Earlier this year, Soviet banking officials and the Singapore Monetary Authority came to an agreement on the establishment of an MNB branch in Singapore. The establishment of a Soviet-owned bank in Singapore will give the USSR another important money market 13/ to tap and could help develop Soviet exports to that area. There have been instances, for example, of local banks being reluctant to provide credits to importers of Soviet goods. Thus, a Soviet bank in Singapore not only could provide these short-term credits but also could induce other local banks to participate in such financing.

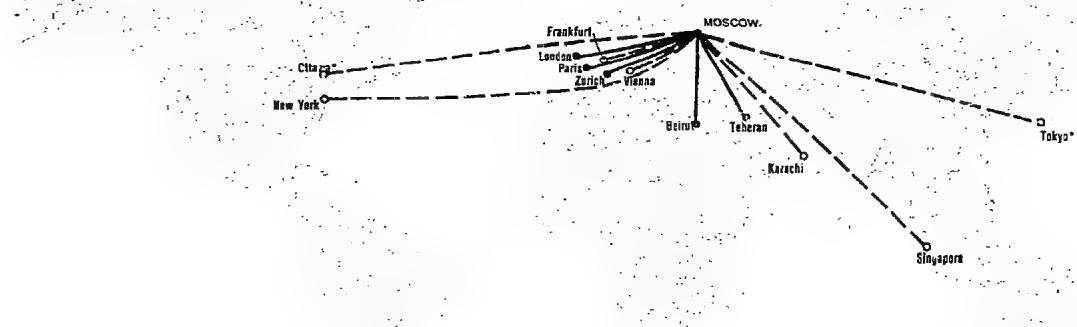
25. Soviet banking officials apparently have been negotiating during the past year or so for the establishment of some sort of banking facility in Karachi, Pakistan, but their motivation is unclear. Soviet trade with Pakistan, while growing, is relatively small – even when compared with Soviet trade with other less developed countries – and for the most part is conducted on a barter basis. Beyond increasing the Soviet presence in Pakistan, it might promote the further development of their mutual trade. As such, it would be comparable to the Russo-Iranian Bank in its scope

13. The Government of Singapore recently announced plans to make the republic the banking and financial center of Southeast Asia.

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SOVIET-OWNED BANKS



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- Established banks and branches
- - - Proposed banks, branches, and representative offices

*Soviet authorities have not disclosed the locations for the proposed banking facilities in Canada and Japan.

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and activities. Otherwise, there appears to be little justification for the establishment of a banking facility in Pakistan.

26. From time to time, Soviet banking officials have indicated a desire to establish banks, bank branches, or representative offices in other Western countries, including the United States, Canada, Japan and Austria. According to the MNB annual report for 1970, Moscow Narodny - in addition to the branch in Singapore - plans to open a representative office in Canada in the "nearest future."

27. Since the mid-1960s, Soviet officials have indicated an interest in establishing a banking facility in New York. The current volume of US trade with the USSR clearly does not call for a Soviet bank in the United States, the present business being handled by US correspondents of Soviet banks. Certain advantages would accrue to the USSR, however, if it were to establish an independent bank or branch bank in the United States. It could, for example, make use of the important New York money market as a supplement or alternative to the Eurocurrency market. This market also could be a source of additional dollars should Soviet dollar-financed trade, say with Latin America or Africa, be expanded. The negotiations aimed at setting up a branch office of MNB in New York, however, have never advanced beyond the preliminary stage.

Development of Soviet Insurance Operations in the West

28. All Soviet foreign insurance operations are centralized under the Administration of Foreign Insurance of the USSR, also known as Ingosstrakh, whose primary function is to maintain an insurance portfolio covering all Soviet foreign exchange risks - soft currency as well as hard currency. Ingosstrakh currently engages in direct insurance 14/ in all areas of foreign trade and tourism, deals in all types of international reinsurance, 15/ and acts as an agent within the USSR for foreign insurance companies. To meet the increased insurance requirements generated by growing Soviet commercial relations with the West, three private insurance companies, jointly owned by Ingosstrakh and Sovfrakht, the Soviet ship chartering firm, were established in Western Europe. 16/ These were the

14. Direct insurance is the original contract transferring the burden of loss from the insured party to the insurer.

15. Reinsurance is the transfer of all or part of the risk of the original insurer to another insurer. International reinsurance refers to reinsurance between insurers of different countries.

16. The Western-based firms are concerned only with Soviet hard-currency risks, not with "ruble" risks - for example, those associated with Ingosstrakh's insurance of Soviet ships.

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Black Sea and Baltic General Insurance Company, Ltd. in London; Schwarzmeer und Ostsee Transportversicherungs-Aktiengesellschaft (SOVAG) in Hamburg; and Garant Versicherungs-Aktiengesellschaft in Vienna. The chairman of Ingosstrakh is also the chairman of each of these firms, although each firm is a separate legal entity, and each has operational independence under Ingosstrakh policy direction. These firms underwrite their own insurance and reinsurance, but as agents for Ingosstrakh they have enhanced the flexibility and scope of Ingosstrakh's operations in the West. The activities of these firms are discussed in greater detail below.

Black Sea and Baltic General Insurance Company, Ltd.

29. The Black Sea and Baltic General Insurance Company was established in 1925 in London to facilitate the growing Soviet lumber trade with the United Kingdom. Its insurance activities remained limited through World War II, and its subsequent growth can be traced to the shift by Ingosstrakh of its Western reinsurance activities from Germany (where they were handled by SOVAG) to the United Kingdom shortly after the end of the war. Initially concentrating its postwar underwriting activities in the lucrative British marine insurance market (about 90% of total premium earnings in 1956), the company since has both diversified and expanded its operations to satisfy the increasing insurance requirements generated by expanding Soviet commercial relations with the West. Beginning in 1956, share capital was gradually increased from \$280,000 to its present level of \$1.2 million. 17/ Black Sea and Baltic established its first branch in Paris in 1956 and currently has representation in at least twelve Free World countries. 18/ Diversification of underwriting operations was also initiated in 1956, and by 1968 19/ its underwriting categories included marine, 47%; fire, 21%; motor vehicle, 9%; and personal accident insurance, 1%. The company has shown small but consistent profits through the mid-1960s, averaging \$27,000 per annum from 1963 to 1968. During 1964-68, net premium income earnings grew annually at an average rate of 5.1% and totaled \$4.5 million in 1968.

SOVAG

30. In 1927, SOVAG was established in Hamburg to underwrite transportation insurance and, more importantly, to place Soviet reinsurance in the German reinsurance market, which at that time was the most developed in the world. The political isolation of the Soviet Union prior

17. For further details, see Appendix C.

18. They include Canada, Belgium, France, the Netherlands, Greece, Italy, Norway, Malta, Lebanon, Austria, the Sudan, and Jamaica.

19. Data are not available for subsequent years.

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to World War II necessitated the purchase of all Western reinsurance for Ingosstrakh through SOVAG, making it Ingosstrakh's principal European agent until the beginning of World War II. SOVAG's operations were suspended during and after the war, and it was not until 1956 that the decision was made to re-establish its operation. Following a significant increase in 1965, SOVAG's assets fluctuated between \$6.2 million and \$6.7 million through 1968. 20/ During this same period, SOVAG sustained an average annual loss of more than \$7,000, caused in part by the generally poor underwriting practices of the firm, European monetary instability, and setbacks in the fire and transportation insurance lines. In the face of such adverse results, SOVAG scaled down its level of underwriting operations, with net premium income falling from a 1964 level of more than \$2 million to less than \$1 million in 1968. SOVAG seemingly benefited by the retrenchment, showing a profit of \$43,000 in 1968 following three straight years of losses. Since 1968, SOVAG has increased its paid-up capital to 100% of its authorized amount of \$1.4 million (5 million Deutsche marks). This was SOVAG's first move since 1960 to increase its capitalization; previously, it was only 50% paid up. This indicates possible plans for expansion. Currently, SOVAG also has representatives in Belgium and France.

Garant

31. Garant, the last of the Soviet-owned insurance companies established in the West, was set up in Vienna in 1958. Initially, direct underwriting operations were restricted by the Austrian government to transportation insurance and to credit guarantees for Austrian exports in instances where a guarantee was refused by the official Austrian credit institute. From this narrow base, Garant has been allowed to expand its direct underwriting operations to other areas, including automotive, air travel, and unlimited credit guarantee insurance. When first established, Garant also took over all existing Ingosstrakh reinsurance contracts with the West that had been arranged by Ingosstrakh's Vienna office. The firm currently participates in the reinsurance market both as a seller and a buyer, covering approximately 90% of its reinsurance costs in 1969 with sales of reinsurance during the same year. As in the case of SOVAG, Garant's assets have not grown since 1965, averaging \$7.6 million between 1965 and 1969. 21/ During this same period, gross premium earnings 22/ have declined at a rate of 6.2%, reaching a low of \$4.4 million in 1969. Profits have fluctuated between 1965 and 1969, averaging \$12,500 per annum.

20. The last year for which such data are available. For further details, see Appendix C.

21. For further details, see Appendix C.

22. Data on net premium earnings are not available.

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Initial restrictions limiting Garant to the Austrian insurance market were lifted in 1964, and since then the firm has shifted the locus of its operations to West Germany, with the result that by 1968 approximately 70% of Garant's business lay with West German firms and institutions. 23/ Garant has clearly established its reliability in the West, particularly with respect to export credit insurance. Although its growth has stagnated in recent years, it continues to be a sound asset for the Ingosstrakh group. 24/

Soviet Insurance Operations in the West

32. The major underwriting areas of the Ingosstrakh group are related to Soviet trade with the West, coverage of Soviet citizens abroad, and credit guarantees on Western loans to the USSR and Eastern Europe. Direct policies written by these Western-based Soviet insurance companies are often reinsured with Ingosstrakh to provide the parent firm with additional foreign exchange earnings. Although it would seem imprudent to keep such reinsurance within the Ingosstrakh group, 25/ reinsurance represents a source of hard-currency earnings which Ingosstrakh uses to balance off the hard-currency costs of its own reinsurance with non-Soviet companies. The assets accrued to the group from annual premium payments constitute a pool of foreign exchange, which is drawn down only as insurance losses occur. By this means, Ingosstrakh and its affiliates are able to pay for individual losses without affecting Soviet foreign exchange reserves.

33. While Ingosstrakh itself is largely concerned with the coverage of Soviet risks abroad, a significant share of the business conducted by the Western-based firms is now related to the coverage of Western risks, particularly in connection with East-West trade. The emergence of these firms as sellers of insurance is attributable to the increasing confidence of the West in the reliability of Soviet insurance companies. Each firm also deals in lines of insurance completely unrelated to Soviet trade with the West, yet such divergence allows the firm to spread its risks and to increase its overall status within the insurance community. The main thrust of each firm's activities, however, has been in connection with the expanding Soviet trade with the West. Garant has been very successful in its underwriting of credit insurance protecting private risks associated with Western credits advanced to Communist nations. The insurance issued by Garant has traditionally been written on terms more favorable than those offered by any Western insurer, and its position in the field is so reputable that Western

23. This probably reflects the large volume of West German exports to the USSR and other Communist countries vis-a-vis the more moderate level of Austrian exports.

24. For convenience, the three Western-based Soviet insurance companies and Ingosstrakh are referred to as the "Ingosstrakh group."

25. Because the risk would not be spread outside the organization.

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banks will often grant such credit financing on the basis of a Garant policy covering the transaction.

Conclusions

34. Soviet-owned banking facilities in the West have flourished in the past decade with the growth of East-West trade. These banks have developed into diversified banking institutions and together have assets of about \$2 billion. Through close adherence to sound Western banking practice and generally prompt payment of obligations, they have helped to build their financial reputation, which has helped them to attract Western deposits. These banks have developed correspondent relations with a large number of Western banks as well as with banks of the Communist countries. The growth in the financial resources of the Soviet-owned banks has come in large part from the increased deposits of banking correspondents - both Western and Communist - and from the banks' policy of retaining profits, rather than from a growth in equity capital provided by the USSR.

35. The chief function of the Soviet-owned banks is to facilitate East-West trade and, in this capacity, they collect and make trade payments and provide trade financing, largely short term. MNB furnishes a large volume of short-term credits - particularly to the East European countries - while BCEN and Wozchod provide only limited short-term financing of trade, holding most of their resources as deposits with correspondent banks. A share of these deposits with Western correspondents serves to secure lines of credit provided to BCEN and Wozchod by these banks for the financing of East-West trade. The Soviet-owned banks perform a number of other functions, including the provision of banking services to local customers and acting as agents in the sale of gold by the USSR and other Communist countries.

36. The Soviet-owned banks are active participants in the foreign exchange and Eurocurrency markets, where they are both borrowers and lenders. Access to the Eurocurrency market provides additional flexibility in furnishing funds to the banks' Communist customers. Although largely restricting themselves to short-term financing, the Soviet-owned banks have provided small amounts of longer term financing to Communist countries to purchase machinery and equipment and have also arranged consortium loans which provide longer term financing for Communist imports from the West. For the most part, however, the Communist countries have had to go to Western sources to obtain the medium- and long-term financing required for increasing imports of capital equipment.

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37. The USSR apparently intends to open three additional banking facilities in the non-Communist world - in Frankfurt, Singapore, and Karachi. There is also evidence of Soviet interest in establishing some type of representation in Canada, Austria, Japan, and the United States. The rationale for opening banks or branches at these locations would be the same as for the others. Having its own facilities in the West has provided certain additional advantages to the USSR, including the ability to gather commercial intelligence, to tap outside sources of funds, to operate in the foreign exchange and Eurocurrency markets, and to maintain a degree of secrecy in its financial transactions.

38. In contrast to the performance of the banks, the three Soviet-owned insurance companies in the West have had mixed results, although they have been generally successful in their prime mission of protecting Soviet foreign exchange risks associated with Ingosstrakh's underwriting activities. Through diversification and expansion of their operations, and by improvement of their underwriting procedures, the firms have become respected members of the European insurance community. Although the marginality of their position within the insurance community has precluded their becoming important insurers *per se*, these insurance companies have been able to provide significant assistance to the USSR in its trade with the West. The retrenchment and ensuing stagnation of the mid-1960s, when these firms as a group operated at a loss, appear to be over, as evidenced by their improved profit position and SOVAG's apparent plans for expansion. The future growth of the Soviet-owned insurance companies, however, is expected to be slow and deliberate as they concentrate more on meeting the overall requirements of the Ingosstrakh group rather than on expanding their individual operations.

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SECRET**APPENDIX A****The Russo-Iranian Bank**

The Russo-Iranian Bank (RIB) was established under joint Soviet-Iranian ownership in Teheran in 1923. In 1954 the USSR assumed complete ownership, with Vneshtorgbank holding an 84% interest and Gosbank holding the remainder. Originally, RIB was called the Banque Russo-Persane and had branches throughout Iran. This was a period of extensive Soviet-Iranian economic cooperation. By 1934, RIB was one of the largest banks in Iran, with a capital of about \$5 million. By way of comparison, the National Bank of Persia had a paid-up capital of slightly more than a half-million dollars in that year. RIB's capital by 1939 had grown to about \$32 million.

No information is available on RIB's assets in this early period, but the size of its capital suggests that it was at least as large as MNB, whose total assets (not merely capital) were valued at about \$40 million in 1929, before its business began falling off. With the cessation of Iran's foreign trade during World War II and later during the cold war period, RIB's capitalization — and presumably its business, too — fell.

In 1944, RIB's capital was valued at \$200,000; during 1948-51 it stood at about \$250,000. For about 15 years, little was reported about the bank's activities or existence. In March 1967, RIB's total resources were valued at \$14.4 million and its paid-up capital was valued at \$1.3 million. By March 1968, RIB's total resources increased to about \$15.8 million, due primarily to the tripling of equity capital to almost \$4 million. The increase in the bank's equity capital coincides with the return to closer Soviet-Iranian economic relations, and RIB may well play a more active role in the financing of future Soviet as well as East European trade with Iran.

RIB maintains correspondent relations with the Deutsche Bank in Hamburg and with the Irving Trust Company and the Chase Manhattan Bank in New York. Chase Manhattan has been a correspondent since at least the early 1930s.

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APPENDIX B

Balance Sheets of Moscow Narodny Bank, Limited,
Banque Commerciale pour l'Europe du Nord,
and Wozchod Handelsbank, A.G.
as of 31 December 1969 a/

	MNB		BCEN		Wozchod	
	Million US \$	Per- cent	Million US \$	Per- cent	Million US \$	Per- cent
Liabilities	796.6	100.0	954.2	100.0	71.9	100.0
Capital	12.0	1.5	18.0	1.9	4.6	6.4
Reserves and retained profits	7.2	0.9	5.4	0.6	0.4	0.6
Correspondents and other deposits b/	713.8	89.6	871.3	91.3	63.9	88.9
Bill rediscounted	52.5	6.6	c/	c/	c/	c/
Other	11.1	1.4	39.5	6.2	3.0	4.2
Assets	796.6	100.0	954.2	100.0	71.9	100.0
Cash and banks b/	134.0	16.0	829.1	86.9	60.0	83.4
Advances and loans	579.3	72.7	107.9	11.3	9.6	13.4
Securities	71.5	9.0	3.4	0.4	0.2	0.3
Other	11.8	1.5	13.8	1.4	2.1	2.9

- a. Because of rounding, components may not add to the totals shown.
- b. Categories are not entirely comparable. The NNB balance sheet has a category called "short-term deposits" (Wozchod has a category called "Bankendebitoren auf Zeit" -- that is, time deposits) which are not included in the assets side of the BCEN balance sheet. This category is lumped into "cash and banks." On the liability side, NNB lumps together other accounts -- except contra accounts -- in its category "correspondent and other dep. sites."
- c. Not reported, but probably a very small part of total liabilities because of the very limited direct financing by BCEN and Wozchod.

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APPENDIX C

Balance Sheets of the Black Sea and Baltic General Insurance Company, Limited,
Schwarzmeer und Ostsee Transportversicherungs-Aktiengesellschaft,
and Garant Versicherungs-Aktiengesellschaft
as of 31 December 1969

	Black Sea and Baltic		SOVAG		Garant b/ b/	
	Thousand US \$	Per- cent	Thousand US \$	Per- cent	Thousand US \$	Per- cent
Liabilities	<u>6,000 c/</u>	<u>100.0</u>	<u>6,403</u>	<u>100.0</u>	<u>7,026</u>	<u>100.0</u>
Capital	1,200	20.0	1,250	19.5	1,385	19.7
Underwriting reserves	2,334	38.9	1,393	21.8	1,255	17.9
Other reserves	240	4.0	25	0.4	311	4.4
Creditor accounts	2,226 d/	37.1	3,735	58.3	4,075	58.0
Assets	<u>6,000 c/</u>	<u>100.0</u>	<u>6,403</u>	<u>100.0</u>	<u>7,026</u>	<u>100.0</u>
Cash and banks	N.A.	N.A.	727	11.4	4,106	58.4
Real estate and furniture	N.A.	N.A.	49	0.8	129	1.8
Shareholders	N.A.	N.A.	613	9.6	--	--
Debtors accounts	N.A.	N.A.	5,014	78.3	2,791	39.7

a. Because of rounding, components may not add to the totals shown.

b. As of 31 December 1969.

c. Estimate, based on ratio of capital to total liabilities of SOVAG and Garant.

d. Estimate, residual.